

By giving away tangible personal property in Illinois, the donor makes a taxable use of the property and is subject to Use Tax on the cost price of the property purchased to be given away. See 86 Ill. Adm. Code 150.305(c). (This is a GIL.)

December 31, 2007

Dear Xxxxx:

This letter is in response to your letter dated August 10, 2007, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

Please accept this letter as an informal request for general written advice. We are requesting confirmation as to the application of Illinois use tax on products given away without charge for promotional purposes by an Illinois beverage distributor.

PROPOSED FACTS

Our client ('Company R') is a distributor of beverages, headquartered in STATE. Company R holds the license to distribute said beverages within the entire U.S. Currently, Company R has an obligation to the manufacturer to carry out the global marketing plans of the brand in the U.S. In the future, to ensure Company R is making branding decisions in line with the manufacturer's goals, it is the manufacturer's intent to sell 'samples' to Company R below their current inventory pricing, but greater than the manufacturer's cost.

'Samples' is defined by the manufacturer as non-sale usage designed to promote the brand and is categorized as one of the following:

- Free goods provided to the general public,
- Free goods given away at sporting events,

- Free goods given to athletes.

When a purchase order is received by the manufacturer, Company R is initially invoiced at current inventory pricing ('Price'). The goods are then placed in transport and are booked on Company R's G/L as 'Inventory in Transit.' Upon receipt and storage of goods by Company R at various warehouse locations, the goods are transferred into an inventory account on the G/L at Price. The goods are then visible in the database and available for distribution to requesting parties

The warehouse receives an approved sales order indicating the usage type of the product (e.g., Free goods to athletes) and quantity of goods to be shipped to select locations. When the shipment is processed and confirmed, the goods on the sales order (from a G/L perspective) are transferred from the active inventory account into a sub-account reflecting disposition as a sale or sample/promo. Once goods are transferred to a 'sample/promotional' account, Company R's Sales and Distribution Module will automatically generate an off-setting credit memo equivalent to Price minus Sample Price (lower than Price) for products used as samples. The credit memo is thereafter routed to the manufacturer for adjustment on an aggregate monthly basis.

When Company R provides documentation to the manufacturer that the product has been used as a 'sample,' the manufacturer will allow a credit for the agreed upon amount.

- i) *Example:* The intent of the buyer and seller at the time of purchase is to sell samples at \$0.60 per can (Sample Price). Distributor purchases inventory from manufacturer for \$1 per can (Price). Distributor withdraws a can to use as a sample. Distributor then provides a report to manufacturer documenting the usage as a free good for branding and/or promotional purposes. A credit memo is allowed for \$0.40/can (true cost of sample to distributor is \$0.60 per can, the Sample Price).

REQUEST FOR RULING

Based on the proposed facts, we respectfully request a response to the following question:

- What is the measure of tax on samples given away by Company R in Illinois?

CONCLUSION

We believe the measure of tax should be the ultimate purchase price of the samples. Since it is the intent of the seller and buyer to sell and purchase samples @ \$0.60 per can, Company R should remit tax on \$0.60 for each can consumed as a sample.

DISCUSSION

Purchases by Company R for a non-sale promotional use in the State of Illinois are subject to use tax. Company R's tax liability in 'gift' situations is limited to cost price of the goods, according to Illinois State Sales and Use Regulation §130.2050(c), which provides in pertinent part, 'If the employer gives the tangible personal property to the employee instead of selling it to him, such employer must pay Use Tax on the cost price of such tangible personal property to him.'

Company R acquires the samples from the manufacturer at a cost lower than current inventory pricing. The manufacturer issues Company R a credit to represent actual cost price for goods used as samples, without receiving reimbursement for the credit from any other party. Where the retailer receives no reimbursement from such activity, Illinois Sales and Use Regulation §130.2125(b)(1) declares that 'Only the receipts actually received by the retailer from the purchaser, other than the value of the coupon, are subject to tax.' Therefore, we believe that the measure of tax should be based on the actual cost to Company R, which would be \$0.60 per can.

Furthermore, the Illinois State Sales and Use Regulation §140.301(a) defines 'cost price' as the 'consideration paid by the serviceman for a purchase valued in money, whether paid in money or otherwise, including cash, credits and services, and shall be determined without any deduction on account of the supplier's cost of the property sold or on account of any other expense incurred by the supplier;...' Based on our facts, we believe the cost price to Company R is their purchase price, net of the manufacturer's credit. Therefore, we believe Company R should remit tax on \$0.60 per can.

Based on discussions between the manufacturer and Company R regarding the cost for providing samples to the public, the entities have come to an agreement that the manufacturer should not be selling samples to Company R at the same price and profit margin as those cans that are resold to general retailers, primarily due to the fact that the manufacturer realizes most of the benefit from branding strategies such as promotional give-aways. Therefore, we believe Company R is required to report use tax on the final purchase price after the credit from the manufacturer.

A key benefit of the agreed upon procedure is that it simplifies the cost accounting of sample/promotional items and facilitates consistent invoicing methodology for branding related business activity. Rather than initially invoicing the distributor for usage of 'samples' on a projected/estimated basis in conjunction with inventory intended for sale, the manufacturer has decided to invoice the distributor for all inventory at current inventory pricing, and approve/apply a retroactive credit for goods that the distributor demonstrates were used as 'samples.' This ensures that the entities are avoiding a potential bottleneck delay during the initial invoicing process, ultimately minimizing unnecessary journal entries as a result of product usage reconciliation. In addition, the credit process substantiates the usage of the product by the distributor and ensures the distributor provides the manufacturer with the appropriate documentation necessary to approve the credit.

The samples distributed by Company R without charge are explicitly used to promote the branding of the manufacturer's product. Company R thoroughly documents the process and does not receive consideration for the samples. We believe the facts support that the manufacturer credit should be deducted by Company R in computing the correct measure of Illinois Use Tax.

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We understand that an anonymous ruling may not be binding on the State until all the parties are disclosed. However, we look to you for guidance on this important issue. Since time is of the essence, we would greatly appreciate your response as soon as possible. To expedite receipt of your response, please fax a copy to me. If you have any questions or require additional information, please feel free to contact me.

DEPARTMENT'S RESPONSE:

In general, the purchase of tangible personal property at retail for use or consumption in this State is subject to Illinois Use Tax. See 35 ILCS 105/2 and 3. If the retailer does not collect the Use Tax from the purchaser for remittance to the Department, the purchaser is responsible for remitting the Use Tax directly to the Department. See 86 Ill. Adm. Code 150.130. When property is purchased and then given away, the donor has made a taxable use of the property by making such gift. Therefore, it is the donor of the gift who is deemed the end user of the property and who is subject to the Use Tax, rather than the donee. See 86 Ill. Adm. Code 150.305(c).

The donor's Use Tax liability is calculated on the cost price of the property given away. When the property is purchased at retail, the base for calculating Use Tax is the purchase price of the property. If, however, the property given away is a finished product produced by the donor, the donor's Use Tax liability is calculated on the donor's cost price of the materials and products purchased and incorporated into the finished product. See 86 Ill. Adm. Code Section 150.305(b) and (c).

It appears from the information that you provided that the cost price of the product to Company R at the time the samples are distributed is \$1.00. Without additional information, for example, the contract that supports the arrangement, we cannot determine if the subsequent reduction in the product's price to Company R represents a reduction in the cost of Company R's inventory, a credit against future purchases, a commission, or compensation for conducting the promotions on behalf of the manufacturer.

I hope this information is helpful. If you require additional information, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Richard S. Wolters
Associate Counsel

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